

**STATE OF CALIFORNIA**  
**DEPARTMENT OF INSURANCE**  
300 Capitol Mall, 16<sup>th</sup> Floor  
Sacramento, California 95814

REG-2006-00010

January 19, 2007

**INITIAL STATEMENT OF REASONS**

California Insurance Commissioner John Garamendi will consider amendment of Title 10, Chapter 5, Subchapter 7.7, Sections 2697.6 and 2697.61 of the California Code of Regulations (10 CCR §§2697.6 and 2697.61).

**SPECIFIC PURPOSE OF THE REGULATION**

The proposed regulations will allow an intra-authority transfer of funds between the base limits program and supplemental limits program of the CEA.

**NECESSITY**

The California Earthquake Authority ("CEA") writes earthquake insurance. It was established by the Legislature in response to the widespread unavailability of homeowners and earthquake insurance after the 1994 Northridge earthquake. The CEA carefully considers the purpose of its formation when shaping its fundamental objectives, one of which is increasing the availability of earthquake insurance for California renters, condominium owners, and homeowners. As a public instrumentality of the state, the CEA is governed by a board of elected state officials and managed by a staff of primarily civil servants; the CEA is funded largely with private monies.

The CEA enabling statute authorizes the CEA to write basic residential earthquake insurance and, by regulation, the basic product has been divided into a "base" product (the CEA's statutory "mini-policy," "base program," or "base limits policy") and an "optional-limits" product, usually called the CEA's Supplemental Limits Program. The CEA believes that while the base limits policy is quite helpful and would cover, for example, a house and a small amount of personal property and living expenses, it has really been the Supplemental Limits Program that has driven CEA success in policy sales for several years. This is why, in an effort to increase overall sales, the CEA has actively marketed the Supplemental Limits Program products. The CEA sees the Supplemental Limits Program as key to its ability to increase the availability of earthquake insurance for Californians.

The Supplemental Limits Program is supported almost entirely by reinsurance. In fact, for 2007, its reinsurance amounts to almost \$600 million in a reinsurance contract that responds to losses in excess of the CEA's \$50.3 million retention. In addition, the 2007 premium for this reinsurance has sharply increased from years prior. Because regulations require the Supplemental Limits Program to be financed separately from the base program, the sharply increased reinsurance costs mean that Supplemental Limits Program premium revenue will not be received in sufficient time to allow the CEA to pay the 2007 reinsurance premium installments when due.

Without reinsurance, the Supplemental Limits Program cannot exist; and, without the Supplemental Limits Program, the CEA believes that it would lose its key to policy sales.

CEA staff has determined that a two-step plan would allow the Supplemental Limits Program to continue: (1) Supplemental Limits Program rates would have to rise by 32.5 % over two years, and (2) to cover expense obligations until the full effect of the rate increase was achieved, the CEA would have to temporarily transfer capital from the base program to the Supplemental Limits Program. Current regulations do not allow the CEA to make such a capital transfer.

On August 24, 2006, the CEA Governing Board approved the plan and authorized the CEA to petition the Insurance Commissioner for a regulatory change to allow the capital transfer authority required to continue the Supplemental Limits Program.

#### **TECHNICAL, THEORETICAL, AND/OR EMPIRICAL STUDY, REPORTS, OR DOCUMENTS**

The Commissioner did not rely upon any technical, theoretical, or empirical studies, reports or documents in proposing the adoption and amendment of these regulations.

#### **REASONABLE ALTERNATIVES TO THE REGULATION AND THE AGENCY'S REASONS FOR REJECTING THOSE ALTERNATIVES**

No other alternatives to the regulation (including alternatives to lessen any adverse impact on small business) were presented to or considered by the Commissioner. The Commissioner has determined that the proposed amendment will only affect insurance companies and will therefore not affect or impact small business. Pursuant to Government Code section 11342.610(b)(2), insurers are not small businesses. All reinsurers are necessarily insurers.

#### **EVIDENCE SUPPORTING FINDING OF NO SIGNIFICANT ADVERSE ECONOMIC IMPACT ON ANY BUSINESS**

The Commissioner has made an initial determination that adoption of the proposed amendment will not have a significant, statewide adverse economic impact directly affecting business, including the ability of California businesses to compete with businesses in other states.